

## MACROECONOMIC ANALYSIS

## Activity in line with expectations

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### The MICA-BBVA model forecasts 0.2% QoQ growth in the third quarter

### The improvement in net exports offset the negative contribution of consumption in 2Q14

In the second quarter, the Portuguese economy posted growth of 0.3% QoQ (-0.5% QoQ in 1Q14), thanks to the performance of net exports. At the beginning of the year, external sales had suffered particularly from the temporary closure of a refinery, a constraint which was removed in 2Q14. Together with the above, moderation in imports (-0.3% QoQ), after the strong increase in 1Q14 (3.1% QoQ), has brought about a 0.8pp contribution to growth on the part of net external demand.

Meanwhile, the negative surprise came in the form of the private consumption component, which contracted (-0.4% QoQ) after three quarters of improvement, while investment recovered from its plunge in 1Q14 (2.9%, up from -4% QoQ).

### Positive signals from the confidence and activity indicators in 3Q14

The uptick in manufacturing production (0.8% MoM in July) reflects the high level of confidence indicators in the industry, although these appear to have reached their upper limits in 2Q14, while retail sales jumped in line with the continued increase in consumer confidence, in parallel with the positive behaviour of the unemployment rate. In terms of external demand, exports, both of goods and services (especially tourism), continue to improve and the performance of export orders signals the trend will hold. All in all, our MICA-BBVA model forecasts 0.2% QoQ growth in 3Q14.

### Unemployment continues to fall, but remains above the eurozone average

In the last twelve months unemployment fell 2.3pp, down to 14% in July, in a clear downward trend that began at the beginning of last year; in 2Q14 it was joined by job creation (2% QoQ). Meanwhile, labour costs have dropped (-1.8% after 0.5% YoY), especially in their wage component (-1.5% YoY).

### Inflation remains at negative rates in the third quarter

Food prices, especially fresh food, continued to fall in August, keeping headline inflation (HICP) at negative rates for the seventh month in a row (-0.1% after -0.7% YoY), despite the moderation in the fall of most components. However, services prices accelerated in August and returned core inflation to positive numbers (0.7% after -0.2% YoY).

### We forecast domestic demand driving more of growth in the second half of the year

Throughout 3Q14, domestic demand should take over from net exports as the main driver for growth, after posting a negative contribution in 2Q14 (-0.5pp). In general, since the beginning of the year, there has been better than expected performance in the domestic fundamentals, due mainly to the change in unemployment and consumer confidence: private consumption, despite having contracted in 2Q14, is showing a positive YoY trend, and the public sector will siphon off less growth than in years past. The strength of internal demand will have a direct impact on increased imports, which will contain the contribution of net exports.

## Public-sector deficit close to complying with the target of 4% of GDP in 2014

In the last few months, the changing macroeconomic environment and the Constitutional Court's decisions have led the Portuguese government to review its budget strategy for 2014. On the one hand, the improvement in domestic demand and the positive changes in unemployment have meant that fiscal revenues have been higher than initially forecast. On the other, the rulings that civil servants' wage cuts are unconstitutional have caused public spending to rise, leaving the 2014 deficit forecast at 4.1% of GDP. The budget review includes a provision that the target will be met in the medium term, which requires an annual correction of the structural wage of at least 0.5pp.

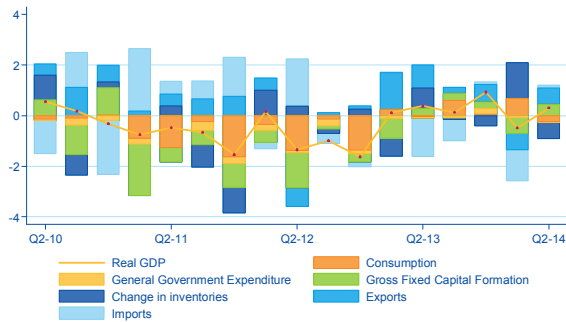
In terms of the public debt, by June 2014 it had risen to 134% of GDP, from 128.9% in 2013, among other reasons because of the funding awarded by the state to the transport companies CP, Carris and STCP, making it necessary to reclassify these firms' debt as public debt, and because of the loan granted by the bank to the Resolution Fund as a result of the BES case. However, the government is confident that it can shrink public debt throughout the second quarter by reducing the central administration's deposits, and it estimates that by the end of the year the deficit will be 130.9% of GDP.

**Portugal**

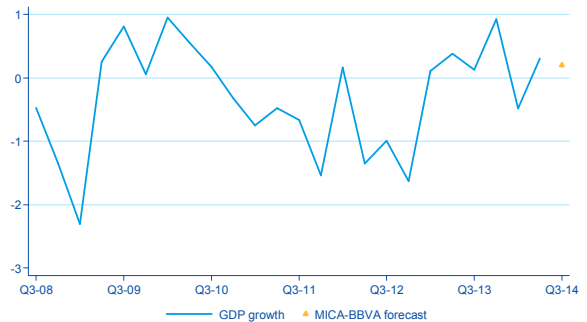
**Domestic accounting: Our MICA-BBVA model estimates growth of 0.2% QoQ in 3Q14**

GDP grew 0.3% QoQ in the second quarter of 2014. The falls in investment and consumption (both public and private) have been offset by the recovery in exports.

**Figure 1**  
**GDP (% QoQ) and contribution by component (pp)\***



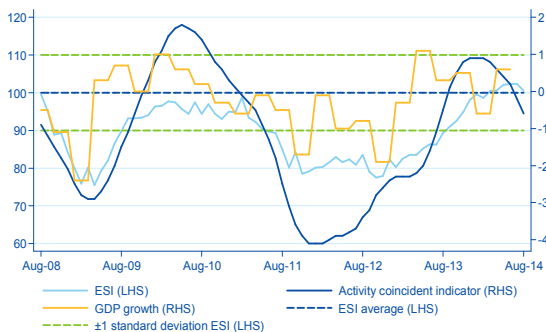
**Figure 2**  
**GDP Growth (% QoQ) and MICA-BBVA forecast\***



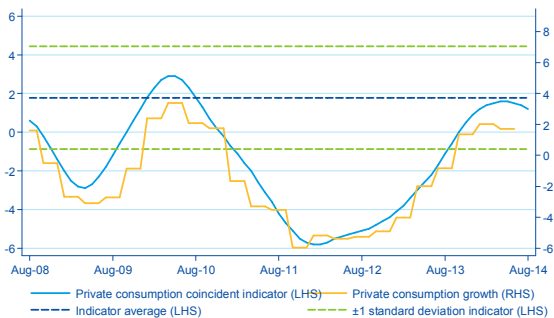
**Confidence: The economic sentiment indicator stabilises at high levels in 3Q14**

According to the EC indicator (ESI), business confidence rose above its historical average in 3Q14. Meanwhile, consumer confidence to August is above the 2Q14 average.

**Figure 3**  
**Confidence (ESI) and coincident activity indicator\***



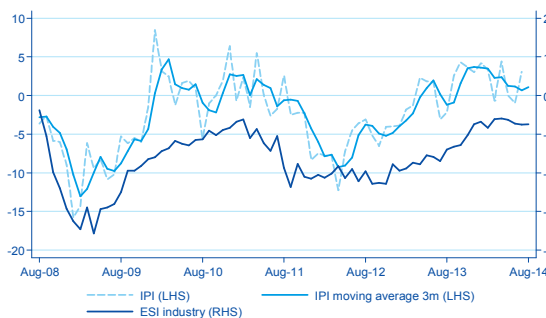
**Figure 4**  
**Coincident consumption indicator and private consumption (% YoY)\***



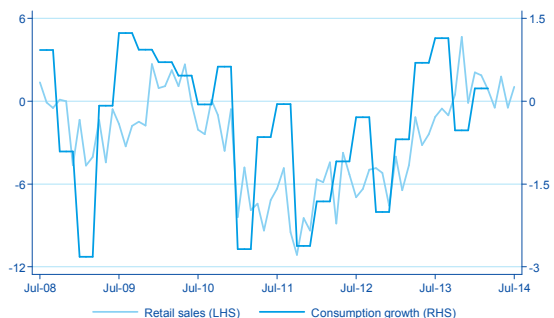
**Activity: industrial production increases and retail sales jump in July**

Industrial production increased in July, after having fallen in the previous two months. Retail sales are bouncing back strongly (+2.3% over the 2Q14 average), encouraged by high levels of consumer confidence.

**Figure 5**  
**Industrial production (% YoY) and industrial confidence\***



**Figure 6**  
**Retail sales (% YoY) and consumption growth (% QoQ)\***

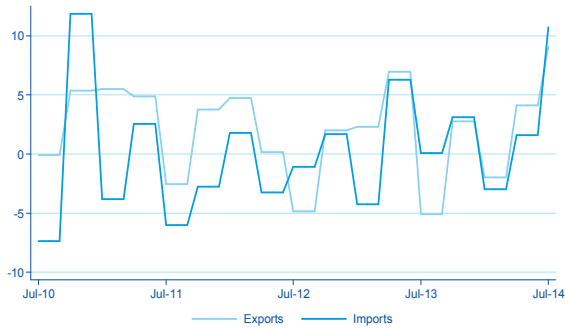


\*Source: Haver Analytics and BBVA Research

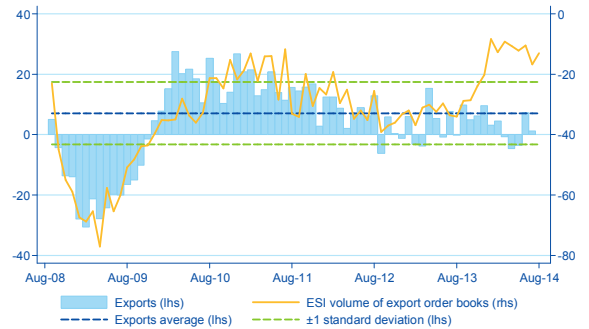
**Foreign sector: goods exports continue to recover**

Goods exports continue to improve after the poor results at the beginning of the year. Meanwhile, services exports, particularly tourism, continue to rise.

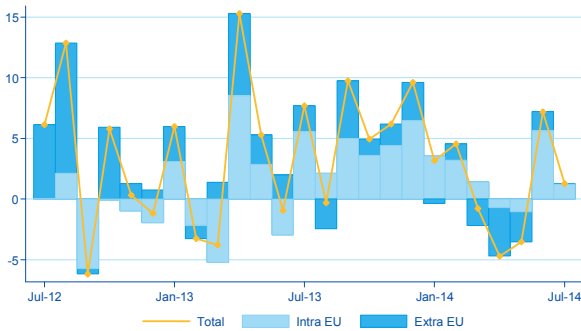
**Figure 7**  
**Exports and imports (quarterly averages, sa %)\***



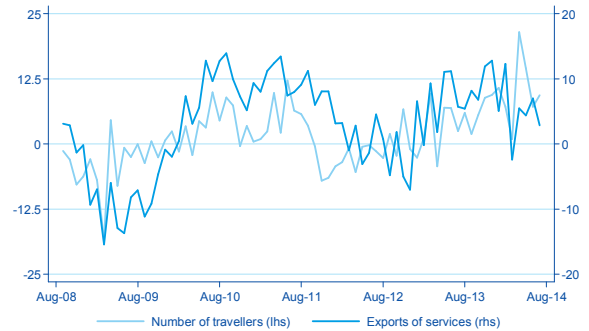
**Figure 8**  
**Exports (% YoY) and export orders \***



**Figure 9**  
**International trade by destination (% YoY)\*sa %\***



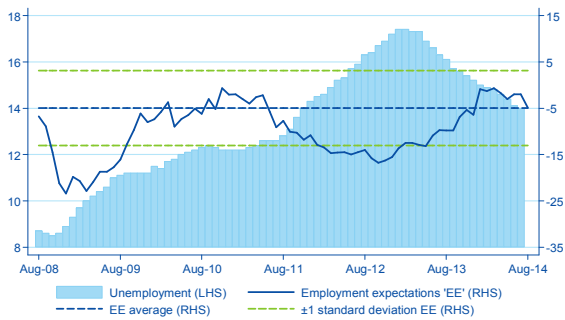
**Figure 10**  
**Tourism and services exports (% YoY)\***



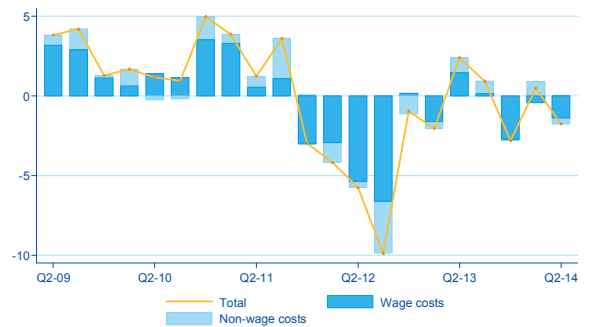
**Labour market: labour costs decline again and the unemployment rate continues its fall**

The unemployment rate has fallen by 2.3pp in a year, down to 14%, in a clear downward trend, although it is not impacting as upward pressure on wages (-1.8% YoY in 2Q14) and employment is growing again (2% QoQ)

**Figure 11**  
**Unemployment rate (%) and employment expectations\***



**Figure 12**  
**Labour costs in the corporate sector (% YoY)\***



\* Sources: Haver Analytics and BBVA Research

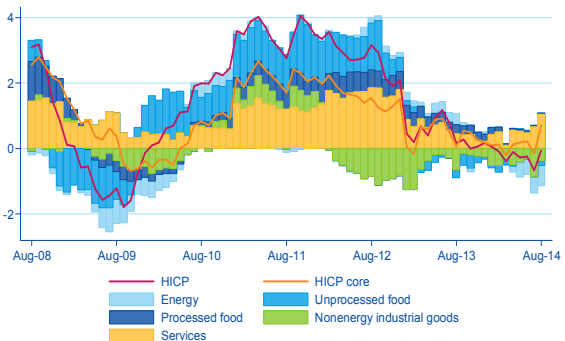
Prices: inflation remains at negative rates in August

Headline inflation (HICP) remained in negative territory in August (-0.1% YoY from -0.7pp), due principally to the fall in fresh food prices. Core inflation, meanwhile, grew to 0.7% YoY.

Figure 13  
Inflation rate, headline and core (% YoY)\*



Figure 14  
Inflation by component (contribution by %)\*



Public finances: the fiscal accounts, close to reaching the budget target

To July 2014, the public administration's accounts indicate that the deficit target, of 4% of GDP, will be met. Although expenditure has risen more than in previous years, this is due to a change in the calendar of payments to public sector employees and old-age pensioners and to the wage increase for civil servants, under the decisions of the Constitutional Court

Figure 15  
Government expenditure (comparison with the previous year)\*

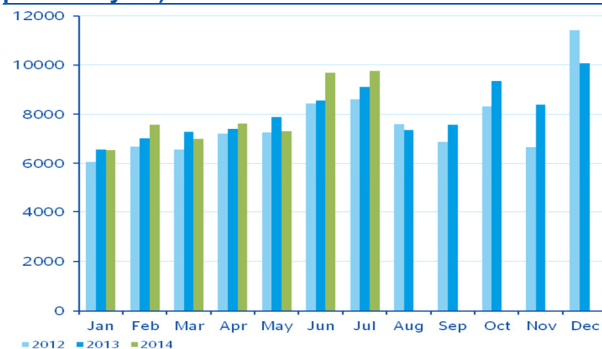


Figure 16  
Government revenue (comparison with the previous year)

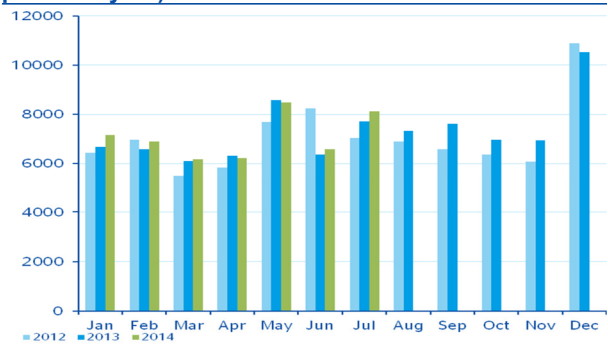


Figure 17  
Public and private debt (% of GDP)

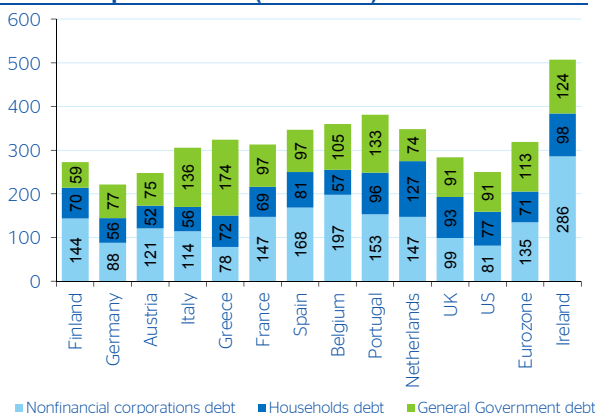
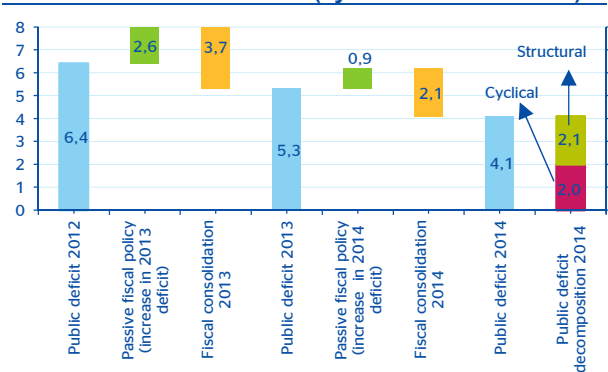


Figure 18  
Breakdown of fiscal deficit (cyclical and structural)\*



\* Sources: Haver Analytics and BBVA Research

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